



Memorandum

To : Mr. Verne Walton

Date : July 28, 1989

From : Eric F. Eisenlauer

Eric F. Eisenlauer

Subject: Correspondence of San Diego County Assessor

In your memorandum of June 29, 1989, to Mr. [redacted] you requested our analysis of a trust agreement submitted for review by the San Diego County Assessor.

The trustors, husband and wife, transferred real and personal property into a revocable trust in 1973. The trust provided that on the death of the first spouse the trust estate was to be divided into two trusts, Trust A and Trust B. Trust A was to contain the surviving spouse's interest in community property and any separate property included in the trust estate as well as amounts necessary to equal the maximum marital deduction for federal estate tax purposes. Trust B was to contain the remainder of the trust estate. The trust provided that on the death of the first spouse the entire net income from both Trusts A and B was to be paid to the surviving spouse. In addition, principal payments could be paid to the surviving spouse in the discretion of the trustee. The trust gave the surviving spouse a testamentary power of appointment over Trust A as well as the power to revoke Trust A but not Trust B during the lifetime of the surviving spouse.

Upon the death of the surviving spouse, Trust A, to the extent not appointed by the surviving spouse was to be added to Trust B and administered thereunder. The trust provided that after the death of the surviving spouse the entire net income of Trust B was to be paid to or applied for the benefit of trustors' son during his lifetime. In addition, principal payments could be made to trustors' son in the discretion of the trustee. On the death of trustors' son, the balance of Trust B is to be distributed to the issue of trustors' son.

Under the terms of the trust, the trustors' son became a co-trustee after the death of his father in 1974 and the sole trustee after the death of his mother in 1981. The Assessor asks whether a change in ownership occurred when the surviving spouse (the mother of the current trust beneficiary) died in 1981.

"Change in ownership" is defined by Revenue and Taxation Code (all statutory references are to the Revenue and Taxation Code unless otherwise specified) section 60 as "a transfer of a present interest in real property, including the beneficial use thereof, the value of which is substantially equal to the value of the fee interest."

Section 61 provides in relevant part that "[e]xcept as otherwise provided in Section 62, change in ownership, as defined in Section 60, includes, but is not limited to:

* * *

" (f) Any vesting of the right to possession or enjoyment of a remainder . . . interest which occurs upon the termination of a life estate or other similar precedent property interest, except as provided in subdivision (d) of Section 62

" (g) Any interests in real property which vest in persons other than the trustor . . . when a revocable trust becomes irrevocable."

Section 62(d) excludes from change in ownership "[a]ny transfer by the trustor, or by the trustor's spouse, or by both, into a trust for so long as (1) the transferor is the present beneficiary of the trust or (2) the trust is revocable; or any transfer by a trustee of such a trust described in either clause (1) or (2) back to the trustor; or, any creation or termination of a trust in which the interest of others does not exceed 12 years duration."

The Board has interpreted the foregoing provisions in 18 Cal. Code Reg. § 462 ("Rule 462") which provides in relevant part:

(a) GENERAL.

* * *

(2) A "change in ownership" in real property occurs when there is a transfer of a present interest in the property, and a transfer of the right to beneficial use thereof, the value of which is substantially equal to the value of the fee interest. Every transfer of property qualified as a "change in ownership" shall be so regarded whether the transfer is voluntary, involuntary, by operation of law, by grant, gift, devise, inheritance, trust, contract of sale, addition or deletion of an owner, property settlement (except as provided in (1) (3) for interspousal transfers), or any other means. A change in the name of an owner of property not involving a change in the right to beneficial use is excluded from the term "transfer" as used in this section.

* * *

(d) LIFE ESTATES AND ESTATES FOR YEARS.

(1) Life estates. The creation of a life estate in real property is a change in ownership at the time of transfer unless the instrument creating the life estate reserves such estate in the transferor or the transferor's spouse. However, the subsequent transfer of such a life estate by the transferor or the transferor's spouse to a third party is a change in ownership. Upon termination of such a reserved life estate, the vesting of a right to possession or enjoyment of a remainderman (other than the transferor or the transferor's spouse) is a change in ownership.

* * *

(i) TRUSTS.

(1) Creation. Except as is otherwise provided in subdivision (2) the transfer by the trustor, or any other person, of real property into a trust is a change in ownership of such property at the time of the transfer.

(2) Exceptions. A transfer to a trust is not a change in ownership upon the creation of or transfer to a trust if:

(A) Trustor-Transferor Beneficiary Trusts. The trustor-transferor is the sole present beneficiary of the trust; provided, however, a change in ownership of trust property does occur to the extent that persons other than the trustor-transferor are present beneficiaries of the trust.

(B) Revocable Trusts. The transfer of real property or an ownership interest(s) in a legal entity by the trustor(s) to a trust which is revocable by the trustor(s); provided, however, a change in ownership does occur at the time the revocable trust becomes irrevocable unless the trustor-transferor remains or becomes the sole present beneficiary.

(C) Trustor Reversion Trusts. The trustor-transferor retains the reversion, and the beneficial interest(s) of person(s) other than the trustor-transferor does not exceed 12 years in duration.

(D) Interspousal Trusts. The exemption afforded interspousal transfers is applicable; provided, however, a change in ownership of trust property does occur to the extent

that persons other than the trustor-transferor's spouse are beneficiaries of the trust.

(E) Proportional Interests. The transfer is to a trust which results in the proportional interests of the beneficiaries in the property remaining the same before and after the transfer.

(F) Other Trusts. The transfer is from one trust to another and meets the requirements of (A), (B), (C), (D), or (E).

(3) Termination. Except as is otherwise provided in subdivision (4), the termination of a trust, or portion thereof, constitutes a change in ownership at the time of the termination of the trust.

(4) Exceptions. A transfer resulting from the termination of a trust is not a change in ownership if:

(A) Prior Reappraisal. Termination results in the distribution of trust property according to the terms of the trust to a person or entity who received a present interest (either use of or income from the property) causing a reappraisal when the trust was created or when it became irrevocable; provided, however, another change in ownership also occurs when the remainder or reversionary interest becomes possessory if the holder of that interest is a person or entity other than the present beneficiary.

(B) Revocable Trusts. Termination results from the trustor-transferor's exercise of the power of revocation and the property is transferred by the trustee back to the trustor-transferor.

(C) Trustor Reversion Trusts. The trust term did not exceed 12 years in duration and, on termination, the property reverts to the trustor-transferor.

(D) Interspousal Trusts. The exemption afforded interspousal transfers is applicable.

(E) Proportional Interests. Termination results in the transfer to the beneficiaries who receive the same proportional interests in the property as they held before the termination of the trust.

(F) Other Trusts. Termination results in the transfer from one trust to another and meets the requirements of (A), (B), (C), (D), or (E) of subdivision (2).

Although Rule 462(i) addresses only the creation and termination of trusts and not specifically the situation where beneficial interests change during the term of a trust, Rule 462(a)(2) states that "[e]very transfer of property qualified as a 'change in ownership' shall be so regarded whether the transfer is . . . by . . . trust . . . or any other means. Thus, we don't believe the failure of Rule 462(i) to address cases such as this precludes a determination that a change in ownership has occurred.

The foregoing provisions make it clear that creating a life estate in real property in trust or otherwise in a person other than the transferor, his or her spouse (and since Prop. 58, his or her child or parent) is a change in ownership. The rationale for this position is that there has been a transfer of a present beneficial interest in real property which is substantially equal to the value of the fee interest.

The foregoing provisions also make it clear that, subject to exceptions not here relevant, a change in ownership occurs when a life estate (in trust or otherwise) terminates and the property vests in possession or enjoyment in the remainderman. The question here is whether the term "remainder" as used in section 61(f) includes an income interest in a trust. It is clear that section 61(f) is intended to apply to trusts because of its reference to section 62(d) which applies only to trusts. The term "remainder," however, is not defined for property tax purposes. We therefore assume that the definitions found in the Civil Code are applicable. Civil Code section 769 provides that "[w]hen a future estate, other than a reversion, is dependent on a precedent estate, it may be called a remainder, and may be created and transferred by that name." "A future estate may be limited by the act of the party to commence in possession at a future day, either without the intervention of a precedent estate, or on the termination, by lapse of time or otherwise, of a precedent estate created at the same time." (Civ. Code § 767.) Estates in real property include life estates as well as estates in fee simple (Civ. Code § 761).

Accordingly, we are of the opinion that the income interest in trust which vested in possession or enjoyment on the death of the surviving spouse in this matter reasonably can be characterized as a "remainder" within the meaning of section 61(f). Moreover, there is no distinction under the property tax provisions quoted above between an income interest for life and a present fee simple interest. The transfer of either is a change in ownership. We therefore conclude that a change in ownership occurred under section 61(f) on the death of the surviving spouse in 1981. Furthermore, since Trust A became irrevocable and terminated on the death of the surviving spouse in 1981, there are additional

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grounds for concluding that a change in ownership occurred with respect to real property held in Trust A under section 61(g) and Rule 462(i)(3).

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cc: Mr. John W. Hagerty